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THE CANADIAN MINING TAXATION REGIME:

A Discussion of Some of its Significant Aspects

A PRESENTATION BY
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TO A WORKSHOP
ON MINING TAXATION

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Canada

FOREWORD

The results of a study on mining taxation conducted by the Institute for Global Resources Policy and Management of the Colorado School of Mines were presented at this event.

The taxation workshop in Chile was a co-operative effort of the Economic Commission for Latin America and the Caribbean (ECLAC), the Foreign Investment Committee, the Internal Tax Service, and the Group of Experts on Mining Exploration and Energy Development (GEMEED-APEC). The workshop had been timed to coincide with the 12th meeting of the Pacific Economic Cooperation Council (PECC) and its Mining Forum, also taking place in Santiago.

This paper is one from a number of countries that were asked to present papers on their particular experience in mining taxation.

For further information on the contents of this paper, or other matters connected with mining, taxation or the investment climate in Canada, the reader is invited to contact:

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The Canadian Mining Taxation Regime:

A Discussion of Some of its Significant Aspects

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Section A

Structure of the Presentation

The Canadian Mining Taxation Regime: *A Discussion of Some of its Significant Aspects*

- Special features
- Administrative issues
- Achieving a balance between "revenue raising" and "international competitiveness"

Canada

CANADA'S EVOLVING MINING TAXATION REGIME

Slide A: Introductory Remarks

- I am happy to be here today at this forum to discuss mining taxation, and most particularly mining taxation from a Canadian perspective.

- In discussions leading to my appearance at this event, I mentioned that I could bring to your attention a number of pertinent aspects about Canadian mining taxation.

- In particular, I intend to explain the reasoning behind some tax provisions that are significant in Canada, and to show you how these provisions affect the competitiveness of Canada's mineral investment climate and the ability of the Canadian mining industry to undertake investment opportunities in Canada and around the world.

A. Special Features

- One such tax provision is the flow-through share mechanism. This was originally a mechanism by which well-funded companies could finance other companies that were without funding, but which had title to properties waiting for exploration. This mechanism has been extended so that deductions can be taken by individuals on their personal income tax returns if the individuals provide funds for exploration carried out by companies; the individuals also obtain shares of the company.

- Another tax provision originated from the special need that was identified in recent years to establish funds for mine reclamation.

- The foreign exploration development expense is one of the provisions that has enabled Canadian companies to be rather successful in terms of their ability to develop properties both in Canada as well as abroad. We see this as being of benefit both to the foreign host country and to Canada and Canadian mining companies, in terms of economic growth and employment.

- Extending this concept of "special features", I will discuss rather "routine" provisions such as the accelerated capital cost allowance, which is a mechanism that essentially enables a mine in Canada to recover its capital cost before paying income taxes. Other special provisions that have been very useful in overcoming the risk characteristics faced by Canadian mining companies include the Canadian Exploration Expenses (CEE), whereby eligible exploration expenditures are given a 100% write-off up to the point prior to a production decision being taken.

B. Administrative Issues

- I will also discuss what I call "administrative issues". This is a reminder that continual monitoring and adjustments have to be made as part of the ongoing administration of the tax system. The resource allowance provision was the subject of a recent review, including consultations with industry and other levels of government. The notion here was to reinforce the resource allowance so that it became implemented, in practice, in the way that government had originally intended.

- Even the 1987 tax reform, which was the last major tax reform for mining and other industries in Canada, was (in one sense) administrative. That is because the federal government's announced intention was to not increase the tax burden, but to respond to a lowering of tax rates (particularly in the United States and the United Kingdom); the government actually responded by removing certain provisions, notably "depletion", as well as lowering rates in Canada.

- I will conclude my remarks by mentioning the ongoing objective of governments in Canada to balance two needs, namely the need to raise revenue from industry (including mining) but also to achieve a balance so that industry can remain competitive in terms of the burden that is imposed - both in relation to other industries in Canada, but also in relation to other mining countries. The results of the recent study by the Colorado School of Mines were relayed to the workshop yesterday. The last part of my presentation reviews some of the Canadian results from our earlier international tax burden comparisons.

Section B

Special Features

Flow-Through Shares

- Flow-through shares facilitate fund-raising by junior mining companies
- Exploration-related deductions are "flowed through" to shareholders
- Shareholder receives 100% tax deduction for the cost of the shares plus potential appreciation of invested capital
- Approximately $160 million in exploration financing was raised via flow-through shares in 1996
- Total non-fuel mineral exploration in Canada amounted to $873 million in 1996

Canada

Slide B1: Flow-Through Shares

- The flow-through share mechanism has been a longstanding and *unique* feature of the Canadian mining taxation regime. Flow-through shares increase the ability of exploration companies to raise equity capital, even in the absence of revenue producing assets. Therefore, they are of great use to junior mining companies that have no or little production income.

- The flow-share mechanism allows companies to pass or "flow-through" their exploration (CEE) and some development (CDE) tax deductions to investors in the shares of the corporation. These investors, provided they pay income taxes in Canada, can then claim these deductions on their own tax returns.

- The advantage of investing in flow-through shares can be two-fold: (i) the individual investor receives a 100% tax deduction for the amount of money invested in the shares, and (ii) the individual investor stands to see the value of the shares appreciate in the event of successful exploration.

- As I mentioned earlier, companies use flow-through shares to facilitate the financing of exploration projects. While this method of financing remains quite popular (an estimated $160 million was raised in 1996), flow-through shares are better known for their extraordinary contribution to exploration levels in the mid- to late-1980s.

- During that period, there existed an extra incentive in the form of the Mining Exploration Depletion Allowance (MEDA). Along with favourable gold prices and stock market conditions, this additional 33⅓% deduction (for a total deduction of 133⅓% on every dollar spent on exploration) resulted in astounding amounts of exploration funds raised. In 1987, for example, $1.1 billion out of a total of $1.3 billion in exploration expenditures was raised via flow-through shares. Another $850 million was raised in 1988.

- Fiscal constraints caused MEDA to be replaced by the Canadian Exploration Incentive Program (CEIP) in 1989. This program was subsequently terminated in 1990, again for fiscal reasons, but it never achieved the same level of success as MEDA.

- Flow-through share financing fell to below $100 million per year until 1995 when it increased to $123 million. The 1997 level will probably be close to the $160 million level recorded in 1996.

- Although MEDA no longer exists, the current flow-through share mechanism with its 100% deduction is still important in helping junior companies finance their exploration activities.

Recent Changes to the Flow-Through Share Mechanism

- Measures were introduced in 1996 to bring the focus of the flow-through share mechanism more towards risky exploration activities
- The "look-back" period was extended from 60 days to one full year
- Exploration companies now have more flexibility in planning their exploration programs

Canada

Slide B2: Recent Changes to Flow-Through Shares

- The 1996 federal budget introduced some technical adjustments to the flow-through share mechanism to render it more efficient and better-targeted towards riskier activities.

- The most significant change introduced is a technical amendment to the *Income Tax Act* affecting the so-called "look-back" rule. This rule was modified to allow exploration expenditures renounced by the company to the flow-through share investor to be incurred up to a full year after the end of the calendar year in which the funds were raised, as opposed to only 60 days previously.

- This longer "look-back" period allows companies more flexibility in planning their exploration projects. A major portion of flow-through funds is usually raised at the end of the calendar year when individual taxpayers are looking for deductions for the year about to end. Under the previous rules, that only gave companies approximately two months in which to spend the funds thus raised.

- Now, however, they have up to a full year to incur expenses they have already renounced to flow-through share investors. While this situation may seem a bit odd, appropriate mechanisms are in place to be triggered when flow-through funds are not fully spent in the time period required - these mechanisms are required because the government does not wish a tax deduction to be taken by an investor unless the exploration is really undertaken, later.

- The extension of the "look-back" period was applauded by the exploration community and will help sustain flow-through share exploration.

Flow-Through Share Financing and Total Exploration Expenditures, 1983-96

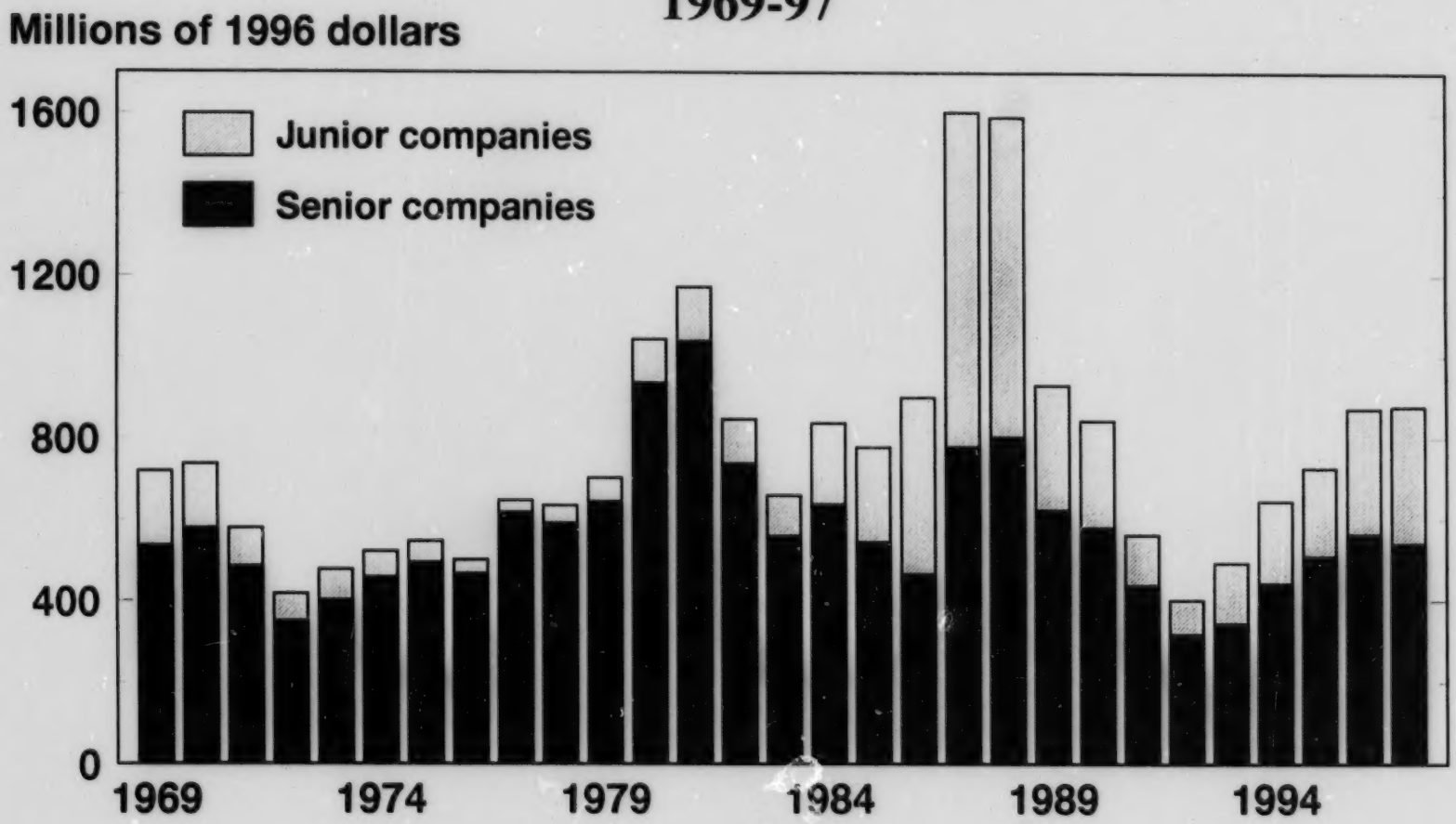
Year	*Total Exploration Expenditures (Current Dollars) ($ millions)*	*Flow-Through Share Financing (Current Dollars) ($ millions)*
1983	472	34
1984	617	139
1985	606	274
1986	723	703
1987	1 300	1 183
1988	1 350	850
1989	828	350
1990	775	250
1991	532	40
1992	385	45
1993	477	70
1994	628	96
1995p	764	123
1996f	945	160-180

Source: Natural Resources Canada
p Preliminary; f Forecast
Note: Beginning in 1986, some of the flow-through share funds raised were actually spent in January and February of the subsequent year (the so-called "look back" period).

Slide B3: Flow-Through Share Financing and Total Exploration Expenditures, 1983-97

- This table gives you some idea of the important amounts of exploration financing that have been raised in Canada through the flow-through share mechanism.

Exploration Expenditures in Canada by Junior and Senior Companies 1969-97



Sources: Natural Resources Canada; Federal-Provincial Survey of Mining and Exploration Companies.

Slide B4: Exploration Expenditures in Canada by Junior and Senior Companies, 1969-1997

- Flow-through shares help maintain a strong junior exploration sector, as you can see on this slide.

Canadian Exploration Expenses (CEE)

- 100% deduction for exploration and pre-production development expenses
- Unused balances can be carried forward indefinitely
- The CEE deduction is optional but widely used

Canada

Slide B5: Canadian Exploration Expenses (CEE)

- Canadian Exploration Expenses are expenses incurred by the taxpayer for the purpose of determining the existence, location, extent or quality of a mineral resource.

- CEE also includes pre-development expenses incurred for the purpose of bringing a new mine into production, including clearing, removing overburden and stripping, and sinking a mine shaft.

- Because of their high risk nature, CEE expenses are accorded a 100% deduction for corporate income tax purposes in the year that the expenses are incurred.

- This 100% deduction is optional, and can be carried forward indefinitely by the taxpayer to be used in a later year.

- Statistics show that, in 1994, Canadian Exploration Expenses totalled $3.3 billion. Of that amount, $2.4 billion was claimed as income tax deductions during that year.

- Part of that amount was actually claimed by investors in flow-through shares who received the deductions (for claiming on their personal tax returns) in exchange for purchasing shares in companies that carried out exploration.

Canadian Development Expenses (CDE)

- 30% declining balance write-off for underground mine development expenses incurred during production
- Unclaimed balances may be carried forward indefinitely

Canada

Slide B6: Canadian Development Expenses (CDE)

- Federal taxing authorities consider mine development expenses less risky than exploration and pre-production development expenses. Accordingly, the treatment accorded to Canadian Development Expenses (CDE) is a 30% declining balance write-off.

- Eligible expenditures for CDE treatment include such costs as those incurred to acquire a Canadian resource property (mineral rights), the cost of mine shafts, main haulageways and similar underground workings that are undertaken *after the commencement of commercial production.*

- CDE are accumulated in a pool called Cumulative Canadian Development Expenses (CCDE). The taxpayer can deduct up to 30% of the unclaimed balance in that pool at the end of each year. Unclaimed balances may be carried forward indefinitely.

- When a corporation does not have taxable income against which to claim CDE, the CDE can be used to create a non-capital loss. This loss can then be carried forward up to seven years or backward to a maximum of three taxation years, where the corporation can use the deduction to reduce its taxable income.

- In 1994, $2.7 billion of CDE was incurred and $1.7 billion was claimed as deductions.

Capital Cost Allowance (CCA) and Accelerated Capital Cost Allowance (ACCA)

- Most mining depreciable assets are eligible for a CCA of 25%
- Capital costs for a new mine, major expansion or assets that exceed 5% of mine income are eligible for an ACCA of 100% to the extent of mine income
- Because of ACCA, new mines do not pay any provincial or federal income tax until all capital has been recovered

Canada

Slide B7: Capital Cost Allowance (CCA) and Accelerated Capital Cost Allowance (ACCA)

- The system of capital cost allowances (CCA) is based on the capital cost (i.e. purchase cost less government grants and assistance such as investment tax credits) of assets that are depreciable properties used for the purpose of gaining or producing income from a business or a property. Assets are allocated to classes for which maximum annual rates are prescribed.

- Most capital equipment acquired by mining (Class 41) can be deducted at a rate of 25% on a declining balance basis, and is subject to the half-year rule.

- One of the most important tax provisions in the Canadian mining taxation regime is the Accelerated Capital Cost Allowance (ACCA). The ACCA can provide for an accelerated rate of depreciation of up to 100%.

- To be eligible for that accelerated rate of depreciation, assets must have been acquired before the beginning of commercial production, for major expansions, or (since 1996) for investment expenditures in excess of 5% of gross income.

- The ACCA effectively allows all capital invested in a new mine to be recovered before paying any income tax. As such, this tax provision is of great benefit to sheltering (from income taxation) the early income of a mining operation.

Rules Facilitating Foreign Investment into Canada

- No restrictions on foreign exchange, and repatriation of capital or profits
- Canadian resource tax treatment can be obtained by incorporating a "Principal-Business Corporation"
- Equity capital can be repatriated tax free
- Withholding tax rates are low and declining

Canada

Slide B8: Rules Facilitating Foreign Investment Into Canada

- From the foreign investor's point of view, several features of Canada's legal and fiscal framework facilitate the planning and management of direct and indirect (portfolio) investment into Canada.

- First, there are no foreign exchange or currency controls in Canada. There are no exchange restrictions on borrowing from abroad, on the repatriation of capital nor on the ability to remit dividends, profits, interest, royalties and similar payments from Canada.

- A foreign investor can also gain access to the special tax incentives provided under the Canadian resource income tax treatment by incorporating a "Principal-Business Corporation" in Canada. A Principal-Business Corporation is a corporation whose principal business is directly related to one or more of the mining or oil and gas activities such as exploration, development, extraction and processing.

- By incorporating a principal-business corporation, a foreign mining company can:

  - obtain additional financing using the flow-through share mechanism;
  - receive a 100% write-off and indefinite carry-forward for its exploration expenses and a 30% deduction for the cost of acquiring resource properties;
  - gain access to the accelerated capital cost allowance for capital costs on green-field mines or major expansions.

- Another attractive feature of Canada's tax system is the ability to repatriate equity capital tax free at any time. For example, a foreign company that invests in a Canadian subsidiary can take all of the amount invested out of Canada before having to pay Canadian taxes.

- By contrast, even when there are no restrictions on capital repatriation, other countries' tax regimes normally require that domestic profits be repatriated first, before equity capital. Usually the repatriation of such profits is subject to withholding taxes.

- The ability to repatriate capital before profits, in conjunction with other Canadian tax rules, means that an investor can defer the time at which he has to pay Canadian taxes.

- As far as the repatriation of profits is concerned, Canada is party to a long list of tax treaties with other countries. This network of treaties offers a wide range of opportunities for the foreign investor to repatriate Canadian profits with low, or no withholding taxes. In addition, Canada is following the Organization for Economic Co-operation and Development's (OECD) worldwide thrust to reduce withholding taxes.

Rules Facilitating Investment from Canada to Foreign Locations

- Interest deduction rules
- Foreign affiliates rules
- Deduction of foreign exploration and development expenses

Canada

Slide B9: Rules Facilitating Investment from Canada to Foreign Locations

- In the case where a subsidiary in Canada of a multinational corporation invests abroad, directly or through its own foreign subsidiaries, there are a number of attractive features in Canada's income tax legislation, including (i) the interest deduction rules, (ii) the "foreign affiliates" rules, and (iii) the "foreign exploration and development expenses" deduction rules.

- (i) foreign companies are often surprised to learn that Canada's tax rules for the deduction of interest expenses are favourable to investment made outside of Canada. These rules allow the deductibility in Canada of interest incurred on borrowing, in Canada or offshore, for investment in the shares of a wholly or partly owned foreign subsidiary, even where the dividends paid by the foreign subsidiary are exempt from Canadian income tax.

- (ii) The foreign affiliates rules define the Canadian income tax treatment of earnings that are generated by foreign affiliates that are wholly or partly owned by a Canadian company.

- Generally speaking, the foreign affiliates rules can serve to foster the use of a Canadian company for investing outside of Canada and for managing cross-border capital flows.

- For example, profits generated by a subsidiary operating in a country with which Canada has a tax treaty can be repatriated to Canada free of Canadian income tax. Also, a Canadian company's foreign investments can be structured in a way that, under the foreign affiliates rules, the tax exempt earnings can be repatriated before the taxable earnings.

- (iii) finally, a Canadian company which invests directly in a foreign mining project and incurs exploration and development expenses can deduct annually, in Canada, a minimum of 10%, and up to 100%, of its unclaimed foreign exploration and development expenses, to the extent of its foreign resource income. Other countries have more stringent limitations on the deductibility of foreign exploration and development expenses.

- All of a Canadian company's foreign exploration and development expenses are accumulated in one tax "pool". This means that, for tax purposes, the company does not have to keep track of these expenses on a property-by-property basis, and not even on a country-by-country basis. Accordingly, proceeds from the sale of a foreign resource property, that constitute foreign resource income, can be sheltered against Canadian tax by the total amount of a company's unclaimed foreign exploration and development expense pool.

- In 1994, a total of $900 million was claimed in foreign exploration and development expenses.

Tax Rules for Mine Reclamation

- Regulatory concern over abandoned mines
  - some companies did not have monies to conduct reclamation activities
- Some provinces have established fund requirements to ensure that reclamation is carried out
- Tax policy issues
  - no deduction had been allowed for fund payments
  - problem of not being able to claim
  - deduction was accorded in 1994 federal budget
  - industry pleased but would also like fund earnings to be tax deferred

Canada

Slide B10: Tax Rules for Mine Reclamation

- Ensuring that mine reclamation is carried out, and that funds are available, is important for sustainable development. This was achieved in 1994 by allowing mining companies to pay into a trust fund, starting early in a mine's life, where the accumulated fund and its earnings would be used later for mine site reclamation.

- The 1994 tax change enabled a company to take a tax write-off for payments into the fund.

- There is still some divergence of opinion on how earnings in the fund should be taxed. The Minister of Finance takes the view that fund earnings should be taxed as they are earned, so that the fund does not operate as a tax shelter. These are the tax laws.

- There is another view that the fund payments are a business expense because they will never be returned to the corporation, but will be used for mine reclamation. In this view, fund earnings, which will also be used for reclamation, are a form of deductible contribution and they should not be taxed as they are earned. This proposition is not accepted by the Minister of Finance. These are not the tax laws.

Section C

Administrative Issues

Sharing of Resources Taxation

- Taxes are levied by federal, provincial/territorial and regional/municipal governments
- Corporate income taxes are levied at the federal and provincial/territorial levels
- Profit-based mining taxes are levied at the provincial/territorial level
- Non-profit taxes are levied by all three levels of government

Canada

Slide C1: Sharing of Resource Taxation

- In Canada, both the federal government and the provinces have corporate income taxation powers. However, under the Canadian Constitution, only the provinces have the right to levy a mining tax or royalty on mineral production in their jurisdictions.

- As a result, there are twelve different mining taxation regimes in Canada, one for each province and territory. The only component of the taxation regime that is relatively constant across the country is the corporate income tax, and even that is subject to some variation because of the way some provinces choose to structure their tax systems. For example, in Alberta and Saskatchewan, the taxpayer can deduct, for provincial income tax purposes, the higher of mining taxes paid, or the resource allowance. In British Columbia, the resource allowance is not deductible, but provincial mining taxes are.

- All provincial mining taxes are essentially profit-based. Some provinces, such as Ontario, Quebec and Manitoba impose their royalties at the corporate level; other provinces do so at the mine level.

- The taxes paid under any of these regimes cannot be deducted in determining the taxable income of another regime. For example, mining taxes cannot be deducted when computing taxable income for provincial or federal corporate income tax purposes. Instead, a resource allowance equal to 25% of resource profits allows the total tax burden of a mining corporation to be similar to other sectors of the economy. I will elaborate more on the resource allowance later in this presentation.

- You should know, of course, that as in so many other jurisdictions, Canadian mining companies also pay nonprofit taxes such as sales taxes, payroll taxes and capital taxes.

Resource Allowance

- Replaces deductibility of mining taxes
- "Makes room" for provincial mining taxes
- Protects the federal tax base

Canada

Slide C2: Resource Allowance

- The resource allowance was created to address an issue that arises in federal states where corporate income taxes are payable to two levels of government.

- The resource allowance is a provision in lieu of deductibility of mining taxes in the calculation of corporate income taxes. It is essentially a 25% write-off against federal and provincial corporate income taxes on resource profits. The resource allowance gives the provincial governments "tax room" to levy mining taxes.

- Resource profits include income from extraction, concentration, smelting and refining, and from royalties. Income related to the disposition of property is not considered a resource profit. For the purposes of calculating the resource allowance, no deduction from resource profits needs to be claimed for interest expenses, CEE and CDE. These deductions are taken after the resource allowance.

- At the federal level, the overall effect of the resource allowance is to reduce the corporate income tax rate on resource profits by another 25%. This results in a real corporate income tax rate of 21.84 (including a 4% surtax) on the resource profits of mining companies.

The Technical Committee on Business Taxation

The Committee will advise on how to improve the tax system to:

- Promote job creation
- Facilitate compliance
- Enhance fairness

Canada

Slide C3

Current Issues in Canadian Mining Taxation: The Technical Committee on Business Taxation

- This committee is an independent panel of legal, accounting and economics professionals.
- It was established in 1996 to review Canada's business taxation regime with a view to:
    - promoting job creation and economic growth;
    - facilitating, and reducing the cost of, compliance and administration;
    - ensuring that all businesses share the cost of government services.
- The committee is to report to the Minister of Finance by the end of 1997.

Consolidation of Profits and Losses

- Deductions for non-capital losses and net capital losses are allowed for income and mining tax purposes
- Corporate taxable income is the sum of the taxable incomes of all corporate divisions (net of deductions, credits and losses)
- Generally, unused losses, deductions and credits of one subsidiary cannot be used to reduce the taxable income of another subsidiary

Canada

Slide C4: Consolidation of Profits and Losses

- The Canadian income tax system allows, in computing taxable income, deductions for non-capital losses from prior years; and net capital losses from prior years if the business is carried on by a corporation for profit or with a reasonable expectation of profit. These provisions also apply to mining taxation.

- A non-capital loss is the excess of a corporation's losses from non-capital sources (i.e. office, employment, business or property) over net income. Non-capital losses can be applied against taxable income earned in previous or future years (there are no tax refunds for these losses). They can be carried back to a maximum of three years, and forward to a maximum of seven years. These losses can only be applied against the income of the corporations that incurred them. In addition, when a change of control occurs, any non-capital loss is restricted to a deduction against income from the same or similar business. In the case of loss carry-forwards, the tax benefit of the losses is deferred until such time as the company returns to a tax-paying position.

- Net capital losses are defined as the excess of allowable capital losses over taxable gains for a taxation year. Net capital losses can be carried back three years and forward indefinitely. If there is a change in control of a corporation, the corporation is not entitled to deduct any net capital loss for a preceding taxation year.

- In Canada, income tax assessment is not performed on a project basis, but on a corporation basis. That is, Canadian income tax rules do not impose *ring fencing* limitations on the pooling of intra corporate revenues and losses such as found in some countries (e.g. Republic of South Africa, Papua New Guinea). Thus, the taxable income of a corporation is derived by combining and netting out the revenues, deductions, credits and losses of all corporate divisions.

- However, Canadian income tax rules, unlike those of some other industrialized countries (such as the United States, United Kingdom, Germany), do not contain provisions for consolidated tax returns or any formal intercorporate loss transfer mechanisms. As a result, in Canada, the unused losses, deductions and credits of one subsidiary often cannot be used to reduce the amount of taxable income of another.

- Consolidated returns were a part of Canadian tax rules from 1932 to 1952. These rules permitted loss sharing between a parent company and its wholly-owned subsidiaries. A surtax of 2 per cent was imposed on groups electing to file consolidated returns. The rationale for eliminating the election in 1953 was the introduction of loss carry-forward and carry-back rules, and the undesirability of providing benefits to consistently losing corporations.

- In 1985, a formal loss transfer system was proposed. It was, nonetheless, not enacted due to concerns from both the provinces and the federal government about possible revenue losses.

- There are, however, certain tax planning techniques for using losses that effectively enable companies to transfer losses to related companies. These mechanisms used to transfer losses between related companies involve additional costs for companies. Certain mechanisms are condoned by Revenue Canada provided they conform to standard business practice. However, the Department of Finance and Revenue Canada review situations of loss transfers and when necessary either announce legislative changes to prevent abusive transactions or reassess corporate taxpayers.

Note: An Important Caveat

- You can see how important is this concept of "ring-fencing" that I have just mentioned.

- The treatment adopted in a particular circumstance, in a particular country, is important in determining the ability of a mine to use, or not use, a tax deduction - and when.

- In the next section, which reviews our international tax burden studies - we treat every mine on a "project basis" only, for ease of comparison.

Section D

Achieving a Balance Between"Revenue Raising" and "International Competitiveness"

International Tax Burdens
Methods of Evaluation

- Statutory tax rates
- Marginal tax rates
- Average effective tax rates

Canada

Slide D1: International Tax Burdens - Methods of Evaluation

- We have just briefly looked at some aspects of the Canadian tax regime for mining. I would now like to review some of our past international tax comparison studies, in order to emphasize certain structural differences between the tax regimes of different countries.

- Comparing profit-based taxes and royalties among competing jurisdictions is a very complex operation because of the diverse nature of tax regimes.

- There are three approaches commonly used to compare different jurisdictions: the "statutory tax rate"; the "marginal tax rate"; and the "average effective tax rate."

- Statutory rates are the actual rates enshrined in the Taxation Acts of the various jurisdictions. Although a comparison of statutory tax rates is useful, tax analysts should not rely solely on this type of analysis to evaluate the tax competitiveness of a jurisdiction.

- The reason is that there are numerous corrections or adjustments that need to be applied to statutory rates to take into account the effect of surtaxes and automatic deductions before one can calculate the actual amount of tax payable by a company.

- As I alluded to earlier, in the case of Canada, the 25% resource allowance effectively reduces the federal corporate income tax rate from 28% to 21% (not to mention reductions at the provincial level as well). The federal income tax rate is further modified by applying the surtax which brings it to a total of 21.84%.

- Hence, marginal tax rates are more widely used than statutory rates to compare tax regimes.

- Unfortunately, the use of marginal tax rates causes many people to think that the Canadian corporate income tax system is more onerous that it really is. This is because marginal tax rates do not take into account the large number of tax deductions that are found in Canadian mineral taxation regimes.

- A better measure of how onerous a tax regime really is can be obtained by using average effective tax rates. Average effective tax rates do take into account the effect of tax provisions (such as the accelerated capital cost allowance and other tax features) on the timing of tax payments.

- To illustrate this, I will use the case of a mining company located in the province of Ontario.

- The measure of effective tax rates used here is:

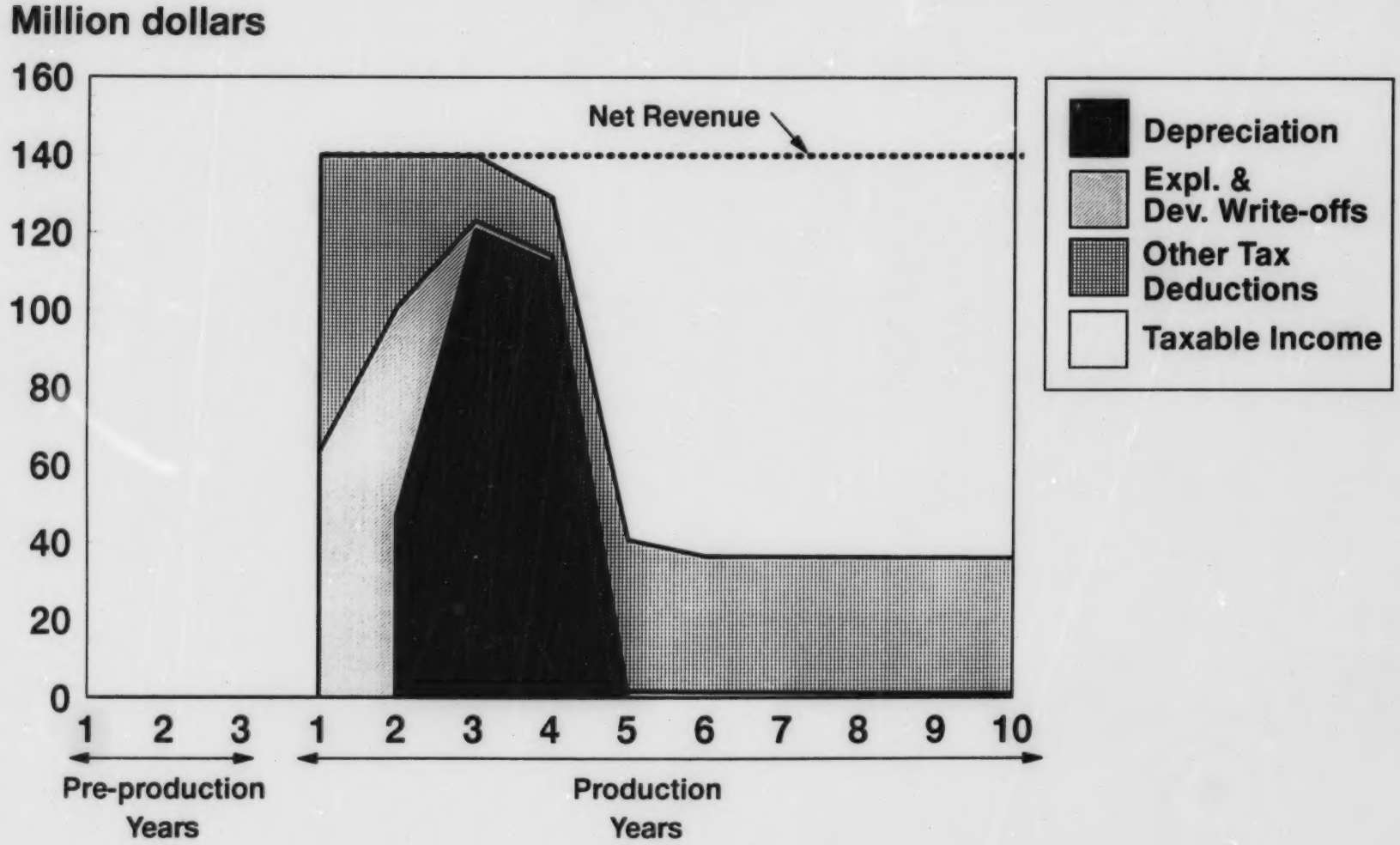
$$\frac{\text{NPV Tax Payments}}{\text{NPV Accounting Income}}$$

- This measure can be interpreted as the fraction of accounting profits paid as taxes.
- It is important to note that we do not use a measure, sometimes used, which is:

$$\frac{\text{NPV Tax Payments}}{\text{NPV Cash Flow}}$$

- The problem for those who use this latter measure is that the fraction tends towards infinity the closer the project's Internal Rate of Return becomes to the discount rate used in the NPV calculation.

Impact of Incentives on the Tax Base
25 Percent Internal Rate of Return
(Ontario)



Slide D2: Impact of Incentives on the Tax Base - 25% Internal Rate of Return (Ontario)

- What you are seeing here is how the Canadian federal income tax system acts to reduce the tax base upon which the marginal tax rates are applied.

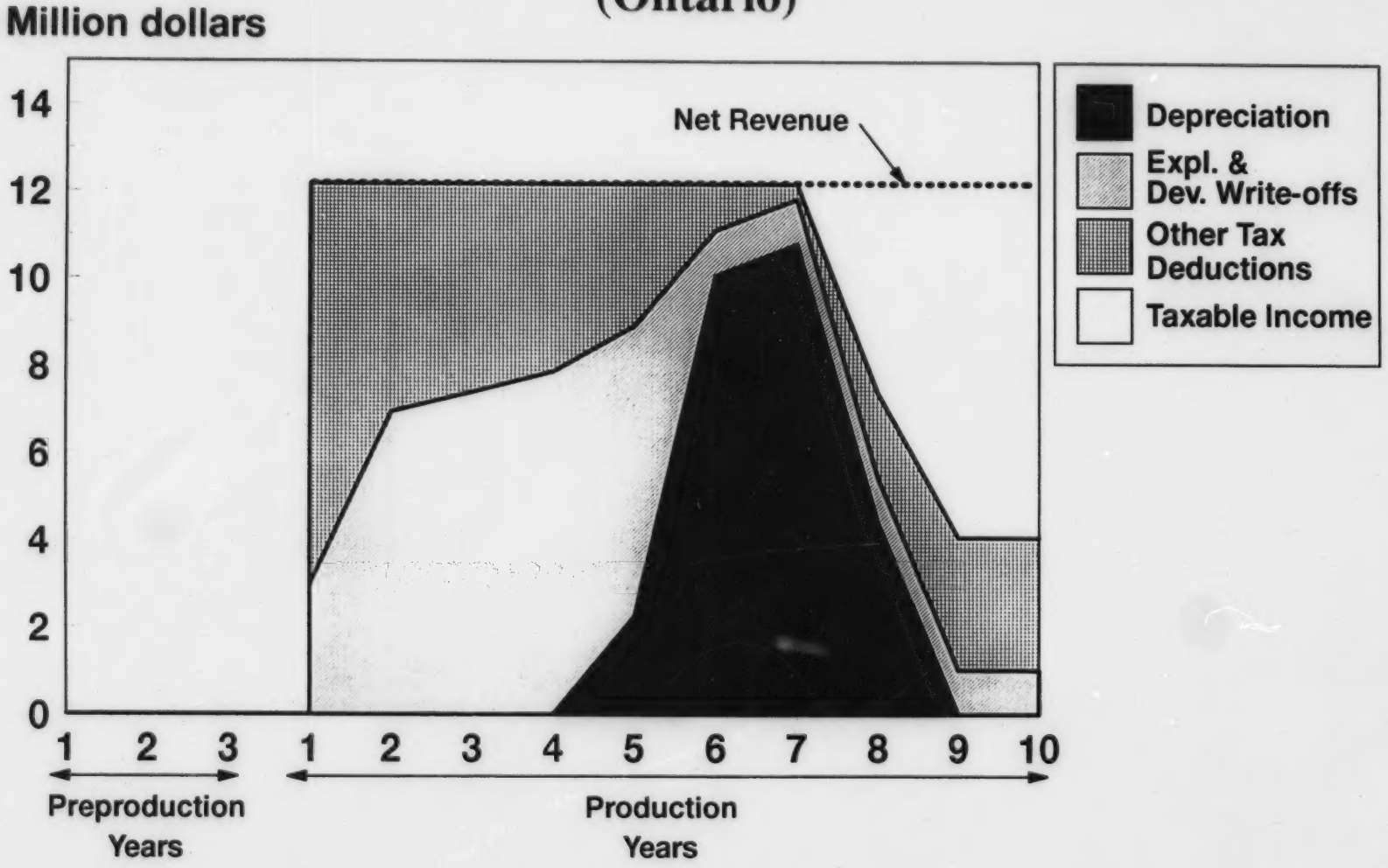
- The shaded areas represent the portion of net revenue that is offset by depreciation, exploration and development write-offs, and other deductions. The white area represents taxable income.

- In this case, we have chosen a profitable operation with a pre-tax internal rate of return (IRR) of 25%.

- For the first three years of production, no taxes will be paid in Ontario. In the fourth year, a very small portion of the tax base is subject to tax. This situation is made possible by the existence of generous and flexible depreciation and write-off rules that are designed to allow the deferral of any tax payment until capital costs are fully recovered.

- It is important to notice here that these features also extend to provincial income taxes, as well as mining tax regimes. In Canada, provincial mining tax regimes are based on profits, and many also feature tax holidays for new mines, and automatic deductions which further reduce the tax base.

Impact of Incentives on the Federal Income Tax Base
10 Percent Internal Rate of Return
(Ontario)



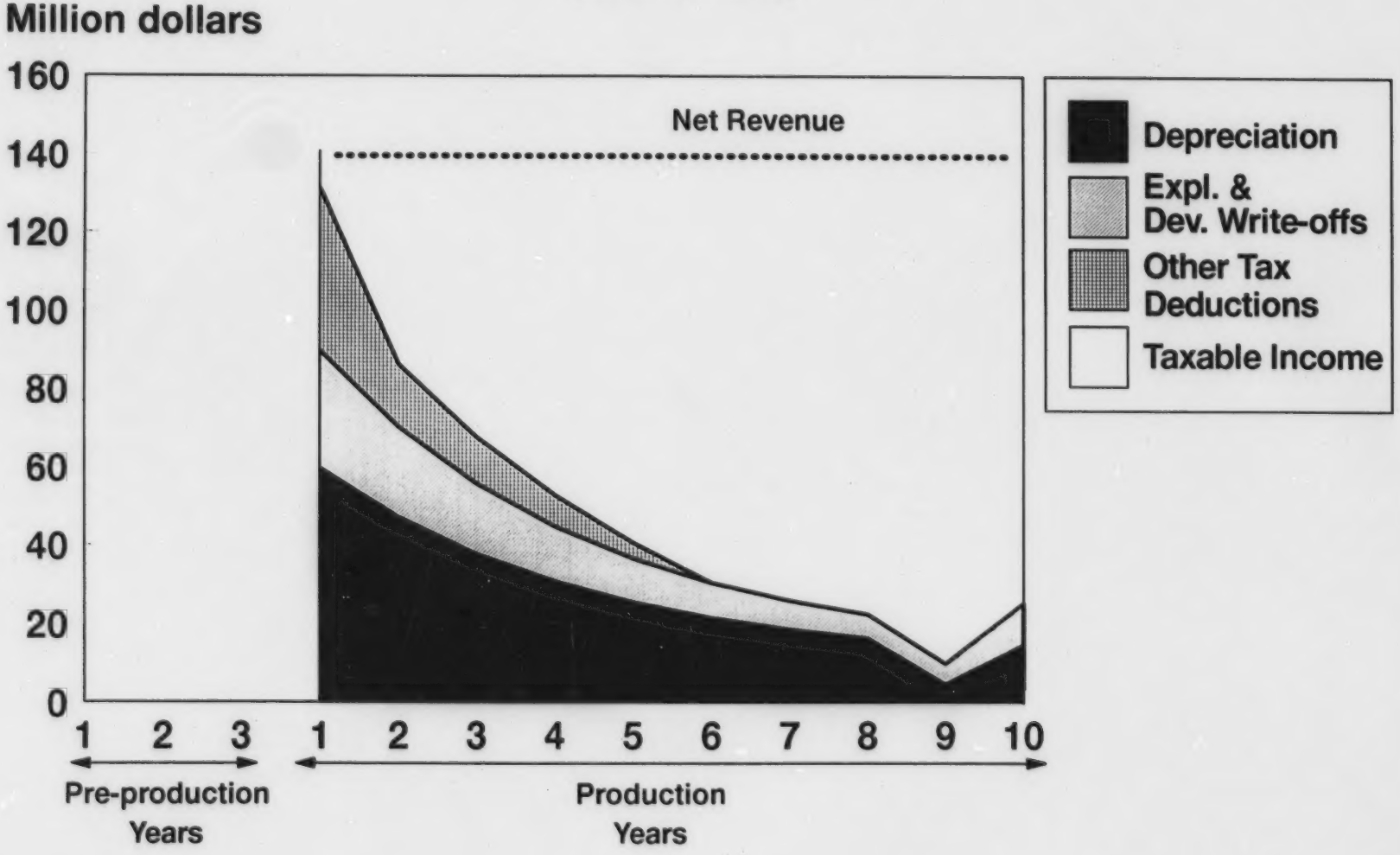
Slide D3: Impact of Incentives on the Tax Base - 10 Percent Internal Rate of Return (Ontario)

- There are circumstances which can make a promising project turn out less profitable than anticipated. The Canadian tax system ensures that these circumstances are not aggravated by tax payments when the project is still in its capital recovery period and faces fixed interest charges.

- This chart shows the impact of income tax incentives on the taxable income of a mine with a 10% IRR (before tax).

- This particular project in Ontario is sheltered from corporate income tax for the first seven years of production.

Impact of Incentives on the Tax Base
25 Percent Internal Rate of Return
(Indonesia)



Slide D4: Impact of Incentives on the Tax Base - 25% Internal Rate of Return (Indonesia)

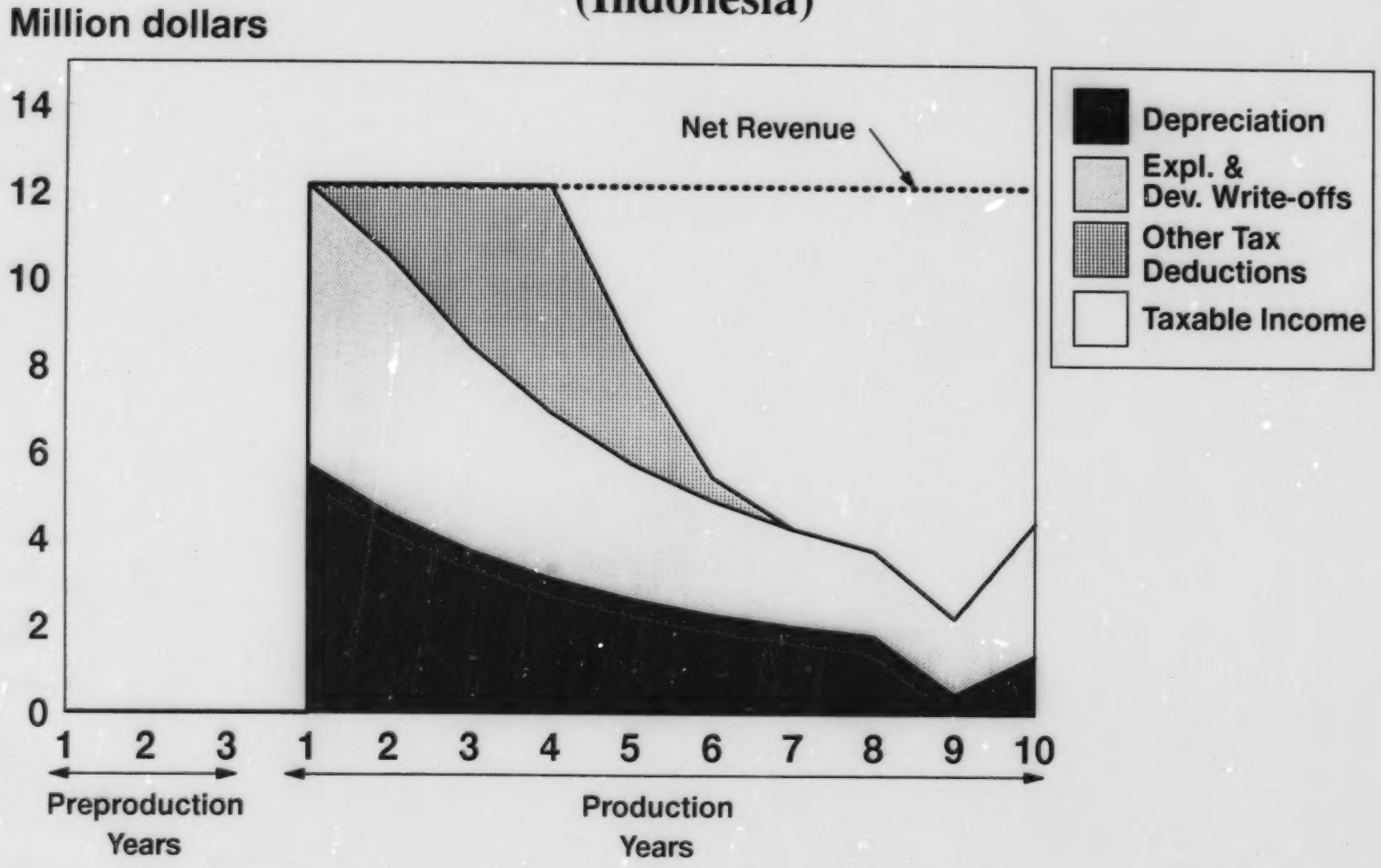
- We have taken the case of Indonesia for comparison purposes. Indonesia is a good example of an income tax regime that tries to match capital costs with revenues. Other countries with a similar tax structure, such as Chile, would lead to basically the same conclusions.

- Indonesia's tax rules, as they applied under the fifth generation contract of work (CoW), give rise to the tax calculations which are shown on this graph.

- If a 25% IRR (before tax) is assumed, a mine will start paying taxes in Indonesia in the very first year of production. You will recall that the corresponding Canadian mine started to pay taxes only in its fourth year.

- Canada offers a tax-free period that is three to four years longer than in Indonesia. On the other hand, once the Canadian project starts to pay tax, it faces a significantly higher marginal tax rate.

Impact of Incentives on the Tax Base
10 Percent Internal Rate of Return
(Indonesia)



Slide D5: Impact of Incentives on the Tax Base - 10 Percent Internal Rate of Return (Indonesia)

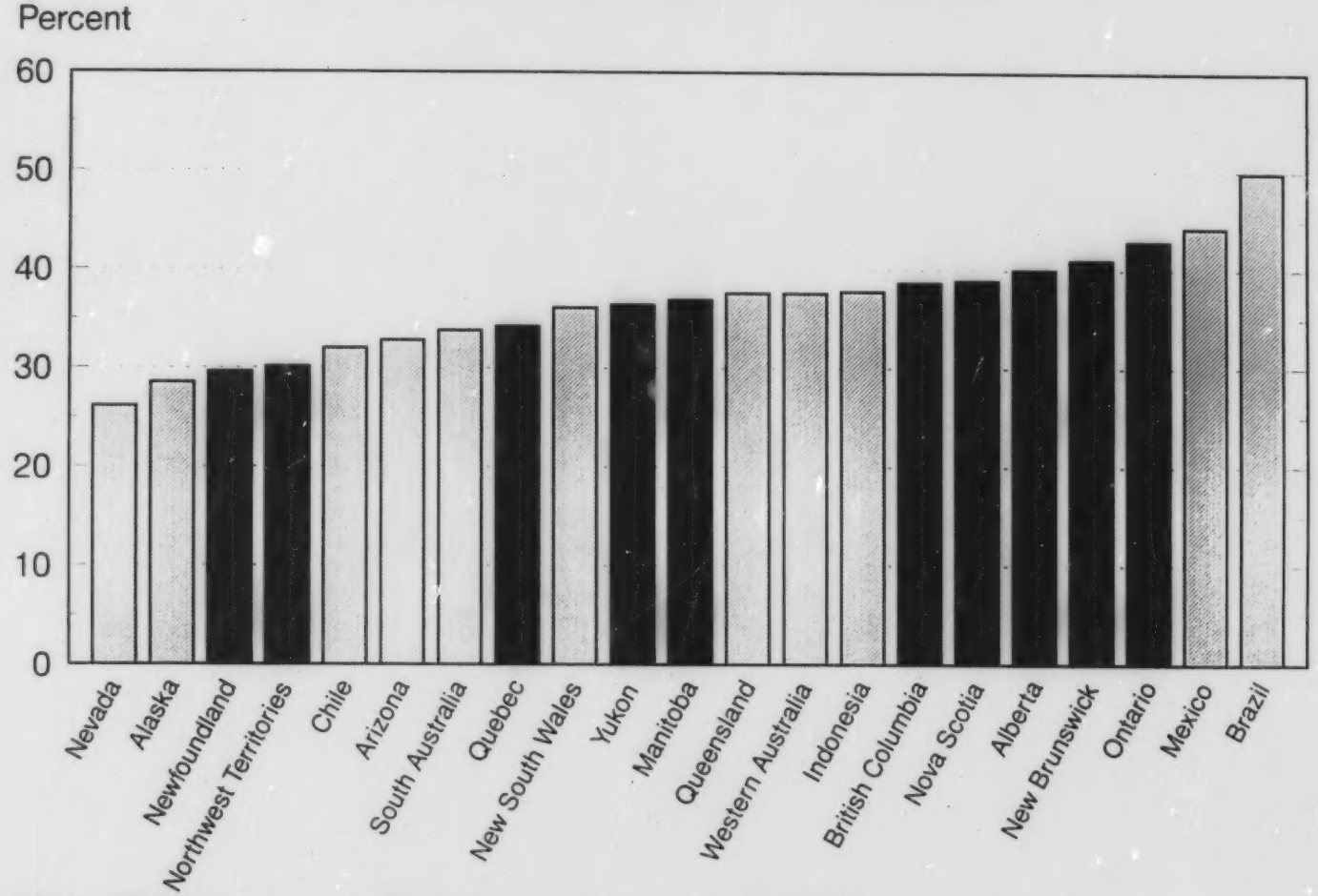
- This slide shows that with a 10% IRR (before tax), a project would start to pay taxes in its fifth year of production in Indonesia, instead of in the seventh year as in the case of Canada.

- What the last four charts have shown is that there are very significant differences in the timing of tax payments between a Canada-like regime and an Indonesia-like one. Canada offers a tax-free period that is two or three years longer than in Indonesia. On the other hand, once the Canadian project starts to pay tax, it faces a marginal tax rate that is significantly higher.

- So, an interesting question is whether companies would prefer to have low marginal tax rates but no upfront incentives, or higher marginal tax rates with fast write-offs and other upfront incentives.

- We would venture to say that it depends on how, in the two situations, the total tax burden compares, on a net present value basis, over the production life of the project. Such an evaluation is the subject of the next three slides.

Average Effective Tax Rates for Base-Metal Operations (25% Internal Rate of Return)



25% Internal Rate of Return pre-tax, mine life of 10 years and discount rate of 7.5%.

Calculations are in respect to income taxes and mining taxes/royalties only. Revised for tax changes as of April 1994.

Source: Minerals and Metals Sector, Natural Resources Canada.

Slide D6: Average Effective Tax Rates for Base-Metal Operations (25% Internal Rate of Return)

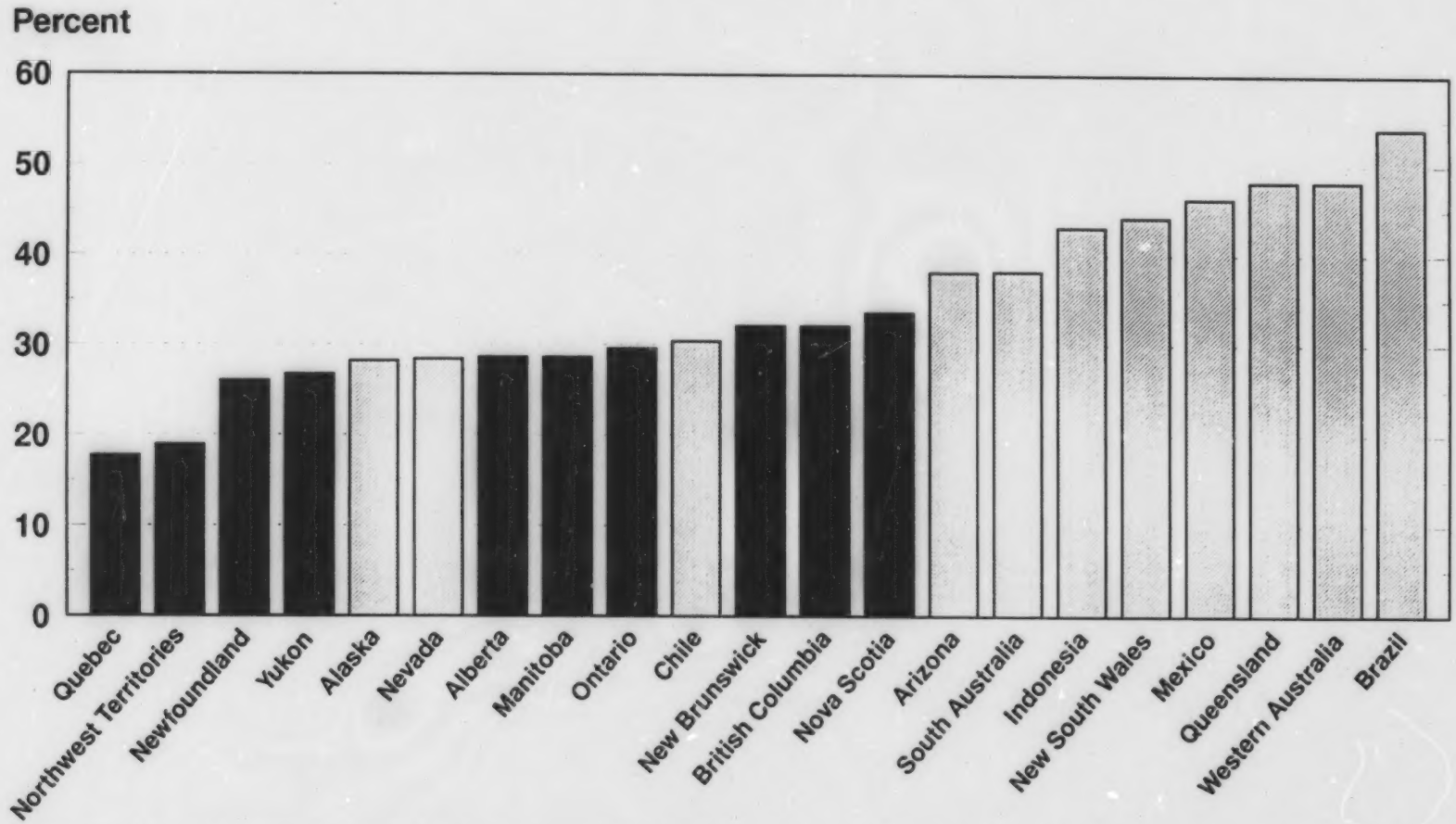
- Here, we have the comparative results for a 25% rate of return base-metal project for 21 jurisdictions. By the way, these results come from our calculations of 1994, and there have been some changes since.

- The effective tax rates of countries like Indonesia or Chile that have no upfront deductions show very little differences from marginal tax rates.

- In contrast, Canadian effective tax rates are 10 to 15 percentage points lower than corresponding marginal tax rates.

- Even though the effective tax rates of some Canadian jurisdictions are rather on the high side, differences with main competitors are much less pronounced than would be suggested by a review of marginal tax rates.

Average Effective Tax Rates For Base-Metal Operations (10% Internal Rate of Return)



Base Case: 10% Internal Rate of Return Pre-tax, mine life of 10 years and discount rate of 7.5%.

Calculations are in respect to income taxes and mining taxes/royalties only. Revised for tax changes as of April 1994.

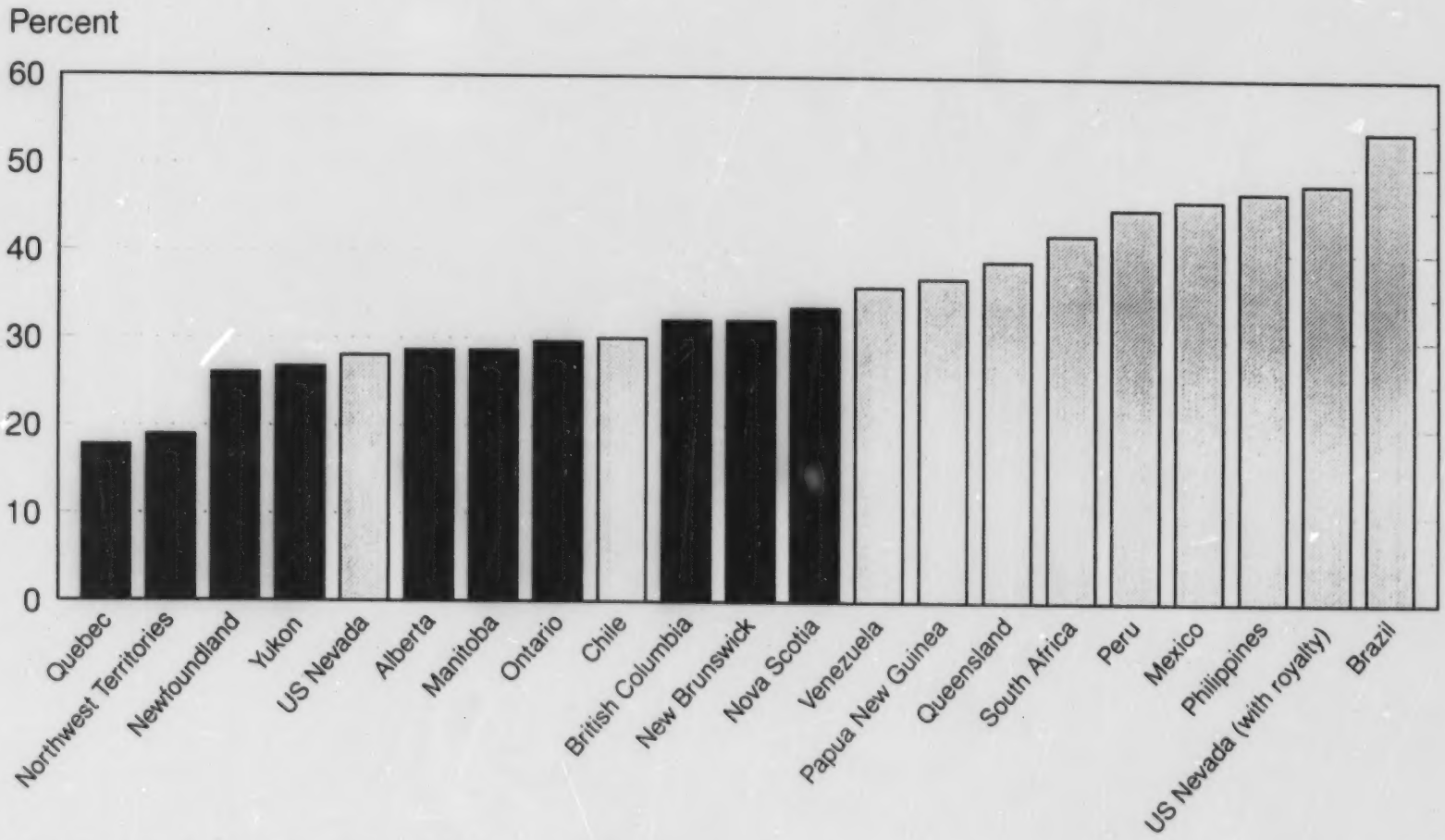
Source: Minerals and Metals Sector, Natural Resources Canada.

Slide D7: Average Effective Tax Rates for Base-Metal Operations (10% Internal Rate of Return)

- In the case of the 10% rate of return base-metal project, the effect of timing is much more pronounced. This is because capital cost write-offs represent a larger proportion of cash flow than is the case for the more profitable project.

- At this level of profitability, Canadian tax rates become among the most competitive by virtue of the very long tax-free period provided.

Average Effective Tax Rates for Gold Operations (10% Internal Rate of Return)



U.S. (Nevada) royalty assumption: 5% of net smelter returns.

Calculations are in respect to income taxes and mining taxes/royalties only. Revised for tax changes as of April 1994.

Source: Minerals and Metals Sector, Natural Resources Canada.

Slide D8: Average Effective Tax Rates for Gold Operations (10% IRR)

- I would like to briefly turn my attention to gold. In contrast to Canada, some foreign jurisdictions tax gold projects differently than base metals. In this slide, Canadian jurisdictions are compared with major gold-producing countries.

- The results of this analysis are quite favourable for Canada.

- Before leaving the subject of tax competitiveness, I should issue some caveats.

- This analysis does not cover nonprofit-based taxes (i.e., sales taxes, fuel taxes or payroll and employment-related levies), withholding taxes or mine reclamation requirements. As a result, we have not addressed the issue of the total tax burden imposed on a mine by a jurisdiction.

- As I have tried to show, one cannot make simple and unambiguous statements about whether a company in a certain jurisdiction is subject to a "high" or "low" level of taxation in relation to its competitors by simply referring to statutory, marginal or even average effective tax rates.

- The actual tax burden of a mine in a given jurisdiction (measured by the proportion of profit taken as taxes by governments) can vary greatly year to year due to a number of factors including: the age of the mine (e.g. have front-end deductions been exhausted or not?), and, profitability (did the mine turn out to be highly profitable or not?) etc.

- It is foolhardy for anyone to make blanket statements about tax burdens. It is extremely important to understand the complexities of taxation; hopefully, this analysis has provided some insights.

Section E

Trends in Canadian Mining Taxation

Trends in Canadian Mining Taxation

- **Movement towards tax base broadening and tax rate reduction**
- **Canada maintains mining-specific tax provisions**
- **Incentives replaced with more efficient and better-targeted ones**

Slide E1: Trends in Canadian Mining Taxation

- The evolution of Canada's mining taxation regime was largely influenced by socio-economic policy objectives, namely the tax reforms of 1972 and 1987 (which recognized the concept of tax neutrality), and by international competition for mineral investment capital.

- Over the last three decades, the tax regime basically evolved from one with generous (but not always cost-efficient) incentives to one that recognizes the specific risk characteristics of the industry while, at the same time, being more reliable and predictable in terms of its administration and revenue generation capacity.

- In the current context, where deficit and debt reduction are the main financial priorities, Canadian governments have acknowledged the need to maintain Canada's competitiveness for mineral investment by successfully maintaining and improving those mining-specific tax provisions that recognize the risks involved in the various stages of mining activity.

Section F

Una Presentación Española

El Régimen Fiscal Canadiense sobre la Minería:

Examen de Algunos de sus Aspectos Significativos

Una Presentación por
Dr. Keith J. Brewer
Ministerio de Recursos Naturales
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Ottawa, Ontario, Canadá

A un Taller sobre
Imposición Fiscal Minera

Patrocinado por
el Ministerio de Minería de Chile
y
la Comisión Chilena del Cobre

Conjuntamente con
el Instituto de Política y Gestión
sobre Recursos Globales
de la Escuela de Minas de
Colorado (EE.UU.)

Santiago, Chile
2-3 de octubre de 1997

PRÓLOGO

En este evento se presentaron los resultados de un estudio que el Instituto de Política y Gestión sobre Recursos Globales de la Escuela de Minas de Colorado llevó a cabo actualmente sobre imposición fiscal en minería.

El taller sobre imposición fiscal, que tuvo lugar en Chile, fue un esfuerzo cooperativo de la Comisión Económica para América Latina y el Caribe (CEPAL), el Comité de Inversiones Extranjeras, el Servicio Interno de Recaudación de Impuestos, y el Grupo de Expertos sobre Exploración Minera y Desarrollo Energético. El taller fue compaginado para que coincidiera con la XII reunión del Consejo de Cooperación Económica del Pacífico (CCEP) y su Foro Minero, que también tuvo lugar en Santiago.

Este documento procede de uno de los diversos países a los cuales se solicitaron ponencias sobre su experiencia particular en el campo de la imposición fiscal del sector minero.

Para mayor información sobre el contenido de esta ponencia, u otros asuntos relacionados con la minería, con la imposición fiscal o con el clima inversionista de Canadá, se invita al lector a que tome contacto con:

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El Régimen Fiscal Canadiense sobre la Minería:

Examen de Algunos de sus Aspectos Significativos

El régimen fiscal canadiense sobre la minería:
Examen de algunos de sus aspectos significativos

- Características especiales
- Cuestiones administrativas
- Logrando un equilibrio entre "recaudación de ingresos" y "competitividad internacional"

Acciones acreditivas

- Las acciones acreditivas facilitan la obtención de fondos por compañías mineras secundarias
- Las deducciones por exploración se "transfieren" a los accionistas
- El accionista recibe el 100% de deducción fiscal del costo de las acciones más la apreciación potencial del capital invertido
- Unos $160 millones aproximadamente en la financiación para exploración se obtuvo mediante acciones acreditivas en 1996
- El total de la exploración minera en Canadá, excluyendo combustibles, representó $873 millones en 1996

Cambios recientes en el mecanismo de las acciones acreditivas

- En 1996 se introdujeron medidas para un mayor enfoque del mecanismo de las acciones acreditivas hacia las actividades de exploración con riesgo
- El período de retroactividad se amplió de 60 días a un año
- Las compañías de exploración tienen ahora una mayor flexibilidad para planificar sus programas de exploración

Financiamiento de las acciones acreditivas y desembolsos totales en exploración, 1983-1996

Año	*Gastos totales en exploración (dólares actuales)*	*Financiamiento con acciones acreditivas (dólares actuales)*
1983	472	34
1984	617	139
1985	606	274
1986	723	703
1987	1 300	1 183
1988	1 350	850
1989	828	350
1990	775	250
1991	532	40
1992	385	45
1993	477	70
1994	628	96
1995p	764	123
1996f	945	160-180

Fuente: Ministerio de recursos naturales de Canadá

p Preliminar; f Pronóstico

Nota: A partir de 1986, algunos fondos de acciones acreditivas obtenidos fueron desembolsados realmente en enero y febrero del año siguiente (el llamado período de retroactividad).

Gastos de exploración en Canadá (GEC)

- Deducción del 100% de los gastos de exploración y desarrollo previos a la producción
- Saldos no utilizados pueden pasarse a años posteriores indefinidamente
- La deducción de GEC es opcional aunque ampliamente utilizada

Gastos de desarrollo en Canadá (GDC)

- Deducción del 30% del saldo decreciente de gastos de construcción de minas subterráneas incurridos durante la producción
- Los saldos no reclamados pueden pasar a años posteriores indefinidamente

Amortización fiscal (AF) y amortización fiscal acelerada (AFA)

- Gran parte de los activos mineros depreciables son elegibles para una AF del 25%
- Los costos de capital para una nueva mina o expansión mayor o activos que excedan del 5% del ingreso de la mina son elegibles para una AFA del 100% en la medida del ingreso aportado por la mina
- En razón a la AFA, las nuevas minas no tributan impuesto federal o provincial hasta que se haya recuperado todo el capital

Reglas que facilitan la inversión extranjera en Canadá

- No hay restricciones sobre el cambio de divisas ni la repatriación del capital o utilidades
- Se puede obtener el tratamiento fiscal canadiense de los recursos constituyendo una "Sociedad que opera una empresa principal"
- El capital propio puede repatriarse exento de impuestos
- Los tipos de retención de fondos para obligación fiscal son bajos y se están reduciendo

Reglas que facilitan la inversión canadiense en el extranjero

- Reglas de deducción de intereses
- Reglas para filiales en el extranjero
- Deducción de exploración y gastos de desarrollo en el extranjero

Reglas fiscales para la recuperación de minas

- Preocupación reguladora sobre minas abandonadas
  - algunas compañías no tenían dineros para actividades de recuperación

- Algunas provincias han establecido requisitos de fondos para asegurar que se lleve a cabo la recuperación

- Cuestiones sobre política fiscal
  - no se permitía deducir los pagos hechos a esos fondos
  - problema por no poder reclamar
  - la deducción fue acordada en el presupuesto federal de 1994
  - la industria minera aplaudió la medida pero desearía que el impuesto sobre los beneficios del fondo fuera diferido

Reparto de la imposición fiscal sobre recursos

- Las cargas fiscales son impuestas por el gobierno federal, los gobiernos provinciales/territoriales y municipales
- El impuesto sobre la renta de las Sociedades anónimas se grava a nivel federal y provincial/territorial
- El impuesto sobre minería lucrativa se grava a nivel provincial/territorial
- Los impuestos de actividades sin utilidades los gravan los tres niveles de gobierno

Deducción por recursos

- Sustituye la deductibilidad de los impuestos mineros
- "Da lugar" a impuestos provinciales sobre minería
- Protege la base impositiva federal

Comité técnico sobre imposición fiscal a empresas

El Comité asesorará sobre cómo mejorar el sistema fiscal para:

- Fomentar la creación de empleos
- Facilitar el cumplimiento de la ley
- Mejorar la equidad

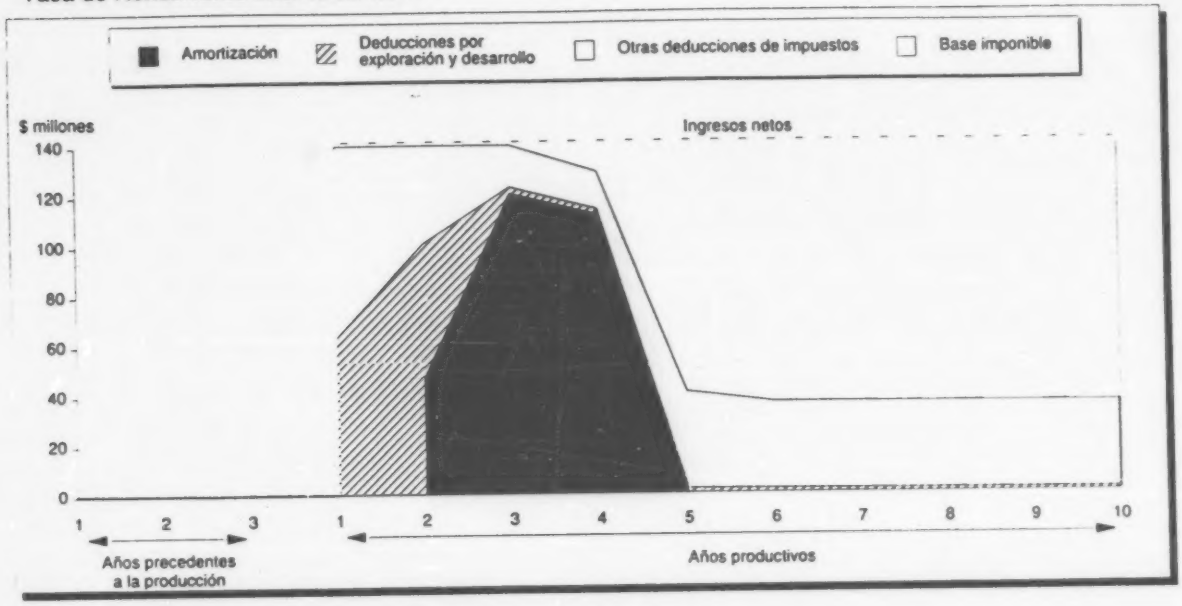
Consolidación de pérdidas y beneficios

- Las deducciones de pérdidas por otros gastos y las pérdidas netas de capital se permiten a efectos de impuestos sobre ingresos e impuestos mineros
- El ingreso imponible de las sociedades anónimas es la suma de los ingresos imponibles de todas las divisiones de la sociedad (deducciones, créditos y pérdidas netos)
- En términos generales, las pérdidas no utilizadas, las deducciones y los créditos de una afiliada no pueden ser utilizados para reducir el líquido imponible de otra afiliada

Cargas impositivas internacionales
Métodos de evaluación

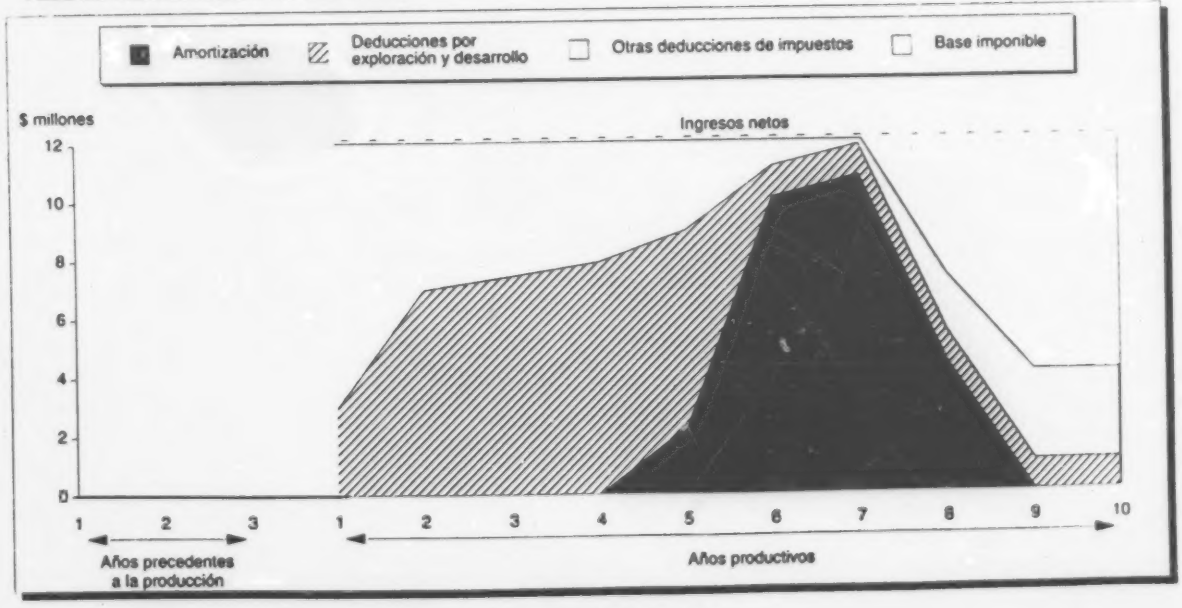
- Tasas impositivas previstas por la ley
- Tasas impositivas marginales
- Promedio de tasas impositivas efectivas

Impacto de Incentivos sobre la Base Impositiva - Ontario
Tasa de Rendimiento Interno del 25%



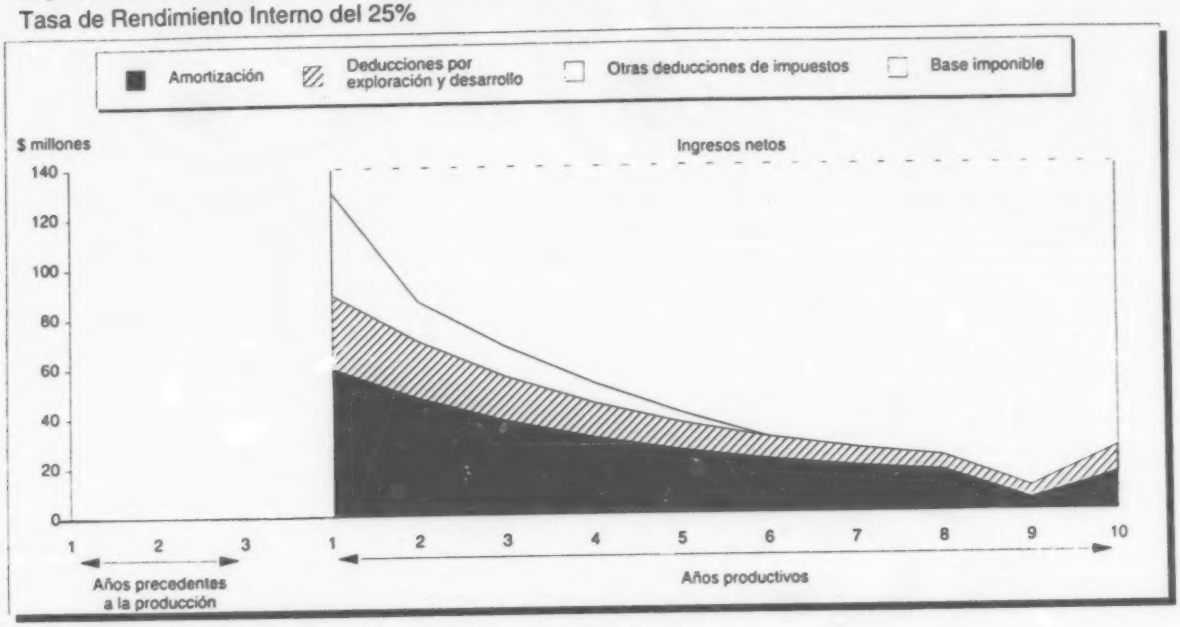
Fuente: Sector de los minerales y los metales, Ministerio de recursos naturales de Canadá.

Impacto de Incentivos sobre la Base Impositiva - Ontario
Tasa de Rendimiento Interno del 10%



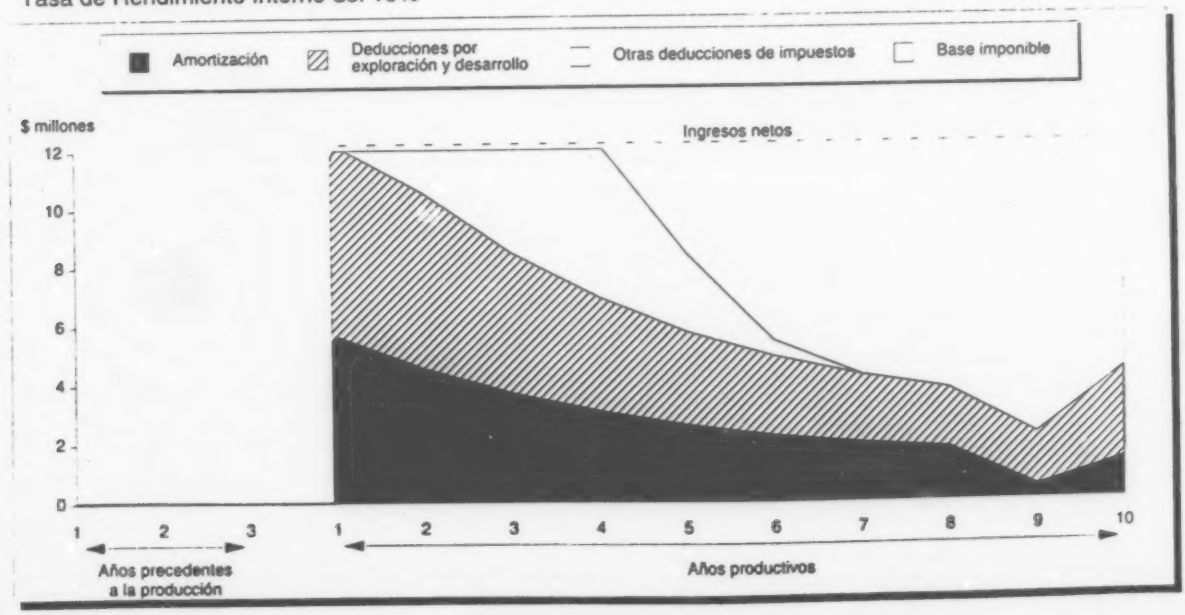
Fuente: Sector de los minerales y los metales, Ministerio de recursos naturales de Canadá.

Impacto de Incentivos sobre la Base Impositiva - Indonesia
Tasa de Rendimiento Interno del 25%



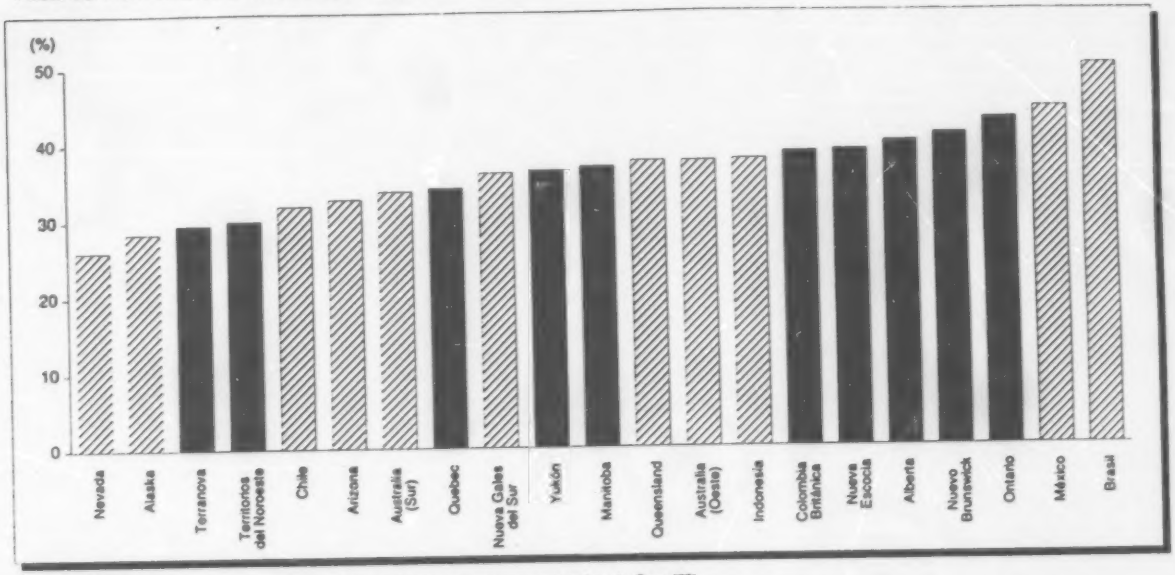
Fuente: Sector de los minerales y los metales, Ministerio de recursos naturales de Canadá.

Impacto de Incentivos sobre la Base Impositiva - Indonesia
Tasa de Rendimiento Interno del 10%



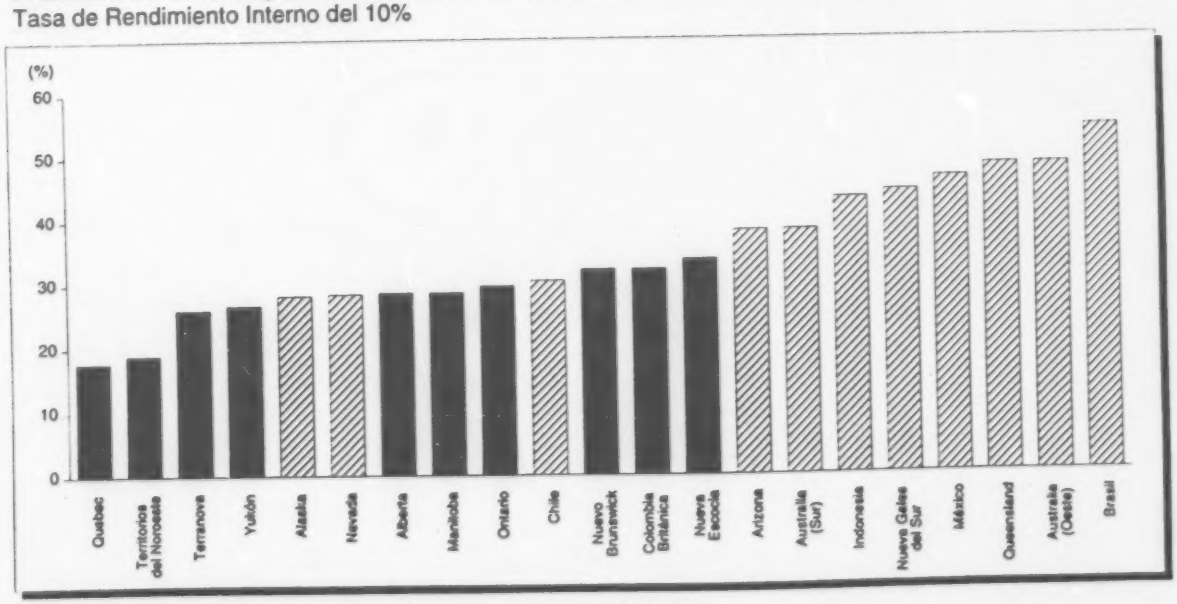
Fuente: Sector de los minerales y los metales, Ministerio de recursos naturales de Canadá.

Promedio de Tasas Impositivas Efectivas en Operaciones de Metales Comunes
Tasa de Rendimiento Interno del 25%



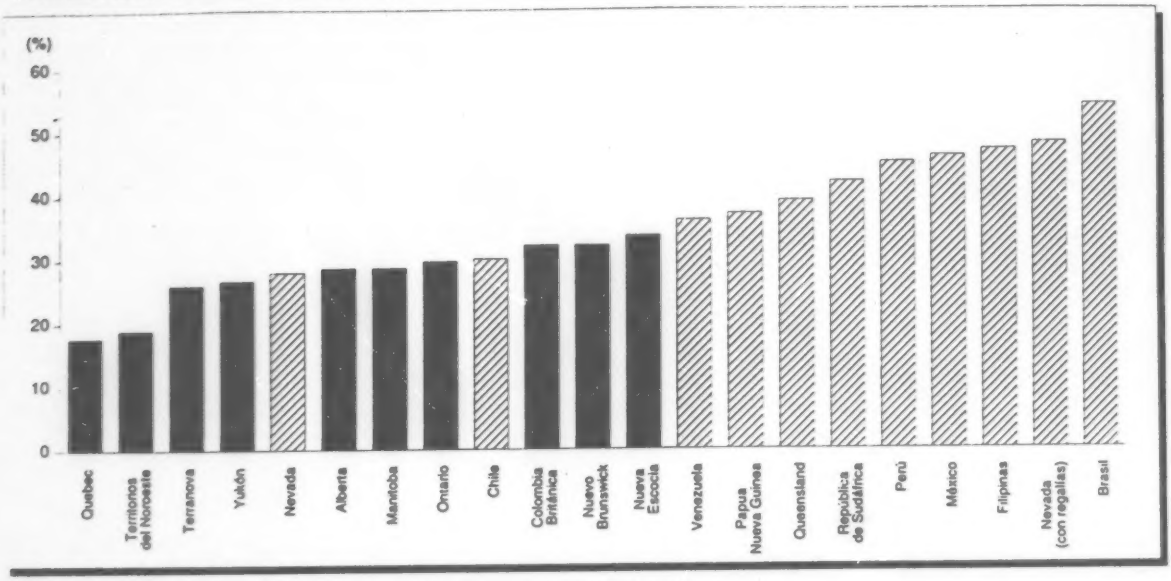
Fuente: Sector de los minerales y los metales, Ministerio de recursos naturales de Canadá.
Notas: Tasa de rendimiento interno del 25% antes de impuestos, duración de la mina de 10 años, y tipo de descuento del 7.5%. Los cálculos son con respecto a impuestos sobre ingresos e impuestos mineros/regalías solamente. Revisado para incluir cambios en imposición en abril de 1994.

Promedio de Tasas Impositivas Efectivas en Operaciones de Metales Comunes
Tasa de Rendimiento Interno del 10%



Fuente: Sector de los minerales y los metales, Ministerio de recursos naturales de Canadá.
Notas: Tasa de rendimiento interno del 10% antes de impuestos, duración de la mina de 10 años, y tipo de descuento del 7.5%. Los cálculos son con respecto a impuestos sobre ingresos e impuestos mineros/regalías solamente. Revisado para incluir cambios en imposición en abril de 1994.

Promedio de Tasas Impositivas Efectivas en Operaciones Auríferas
Tasa de Rendimiento Interno del 10%



Fuente: Sector de los minerales y los metales, Ministerio de recursos naturales de Canadá.
Notas: Tasa de rendimiento interno del 10% antes de impuestos, duración de la mina de 10 años, y tipo de descuento del 7.5%. Los cálculos se hacen con respecto a impuestos sobre ingresos e impuestos mineros/regalías solamente. Suposición de regalías de EE.UU. (Nevada) de 5% de los ingresos netos de fundición. Revisado para incluir cambios en imposición en abril de 1994.

Tendencias en imposición fiscal en la minería canadiense

- Movimiento hacia la ampliación de la base impositiva y la reducción de tasas impositivas
- Canadá mantiene disposiciones fiscales específicas para la minería
- Los incentivos sobre la eficacia en función de costos se reemplazan por otros más eficientes y mejor dirigidos